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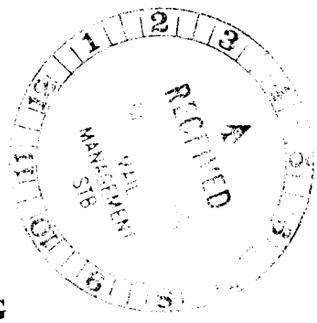
BEFORE THE
SURFACE TRANSPORTATION BOARD

Ex Parte 582 (Sub-No. 1)

PUBLIC VIEWS ON MAJOR RAIL CONSOLIDATIONS



COMMENTS

ON THE

NOTICE OF PROPOSED RULEMAKING

submitted by

THE NATIONAL INDUSTRIAL TRANSPORTATION LEAGUE

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The National Industrial Transportation League ("League") respectfully submits its comments in response to the Notice of Proposed Rulemaking ("NPR") of the Surface Transportation Board ("STB") issued on October 3, 2000. The League welcomes this opportunity to submit its views regarding revisions to the Board's policies on major rail consolidation proceedings.

As it noted in its May 16th response to the Board's Advance Notice of Proposed Rulemaking ("ANPR"), the League agrees that the agency needs to alter its policies and precedents governing rail consolidations. Since the passage of the Staggers Act, the nation's rail industry has developed into a system characterized by two rail duopolies, one in the eastern United States, and one in the west. As this evolution has occurred, the rail-to-rail competition that existed in 1980 has been significantly reduced. However, the policies and precedents governing the agency's consideration of rail consolidations have not kept pace with these

significant changes. Thus, the League agrees with the two fundamental premises of the Board's NPR, first, that a significant overhaul of the agency's rail merger policies is clearly appropriate, and second, that the Board should revise its policies with an eye toward affirmatively "enhancing" competition in future rail consolidation proceedings, rather than simply attempting to "preserve" competition.

However, the League believes that the Board's rules should be revised in several important areas. There are two broad concerns.

First, the League strongly believes that the Board's proposed rules are extremely vague or unclear in a variety of key areas, and that the rules should thus be significantly revised to provide both railroads and shippers with much greater specificity as to how and what competition will be enhanced, and what will be required, in future rail merger applications. In these Comments, therefore, the League provides the Board with specific language to cure what it sees as a serious lack of definition and specificity in many places in the proposed rules.

Second, the League believes that the scope of the Board's rulemaking, which is focused purely on merger policy, would create a serious disparity between the competitive conditions facing merging as compared to non-merging carriers, to the detriment of both merging carriers and the shipping public. Thus, the League believes that the Board must put into place procedures that would work to insure greater rail-to-rail competition for both merging and non-merging carriers, at a minimum as part of the next major merger proceeding, if not sooner. Such a change would create a level competitive playing field for both merging and non-merging carriers and the shippers served by them. In these Comments, the League sets forth suggestions for accomplishing a level competitive playing field between merging and non-merging carriers, to the benefit of shippers and carriers alike.

Finally, the League believes that the Board's proposed rules can be improved in a number of other important areas, including its proposals on the definition and treatment of major gateways; the content of service assurance plans; the treatment of the acquisition premium in rail mergers (a topic not discussed in the Board's proposals); and its proposals for post-merger operational monitoring. In these Comments the League sets forth its views on these and several other areas. The League respectfully requests the Board to consider these suggestions, and to revise its proposed rules in light of them.

I. IDENTITY AND INTEREST OF THE NATIONAL INDUSTRIAL TRANSPORTATION LEAGUE

The National Industrial Transportation League is an organization of shippers that conduct industrial and/or commercial enterprises throughout the United States and internationally. The League is the oldest and largest nationwide organization representing shippers of all sizes of commodities. The League has approximately 600 separate company members, ranging from smaller shippers to some of the largest shippers in the country. The members of the League utilize all modes of transportation to move their goods in interstate, intrastate, and international commerce. Substantial volumes of commodities are shipped by League members via rail. The League participated actively in the Advance Notice of Proposed Rulemaking phase of this proceeding, by submitting comments on May 16 and reply comments on June 5, 2000. Moreover, the League has been an extremely active participant in all of the major rail mergers that have been considered by the agency in the past ten years, and its members are vitally concerned with the agency's rail merger policy for the future.

II. THE BOARD'S DECISION TO REVISE ITS RULES TO REVERSE A POLICY THAT TO DATE HAS FAVORED RAIL MERGERS, AND TO REQUIRE "ENHANCED COMPETITION" IN FUTURE RAIL CONSOLIDATION PROCEEDINGS, IS CORRECT

In its October 3rd NPR, the agency notes that its proposed rules represent a "paradigm shift" in the agency's approach to rail mergers. NPR, p. 10. The agency's current policy statement on rail mergers, established in 1979 and modified in 1981, clearly favors rail mergers. However, the Board's proposed rules establish new procedural and substantive requirements for merging carriers. Thus, the proposed rules depart from the pro-merger stance contained in the Board's current policies, thereby shifting the agency's policy toward a more neutral position. In addition, the Board's proposed rules that would require merging carriers to propose "enhanced competition" in order to cure in future rail consolidations the complex and subtle – but very real – losses in rail competition that have been permitted in previous mergers through application of the Board's current merger policy.

The League believes that the Board is correct in proposing a fundamental shift in the agency's merger policy away from a policy that has clearly favored rail mergers. The League also believes that it is appropriate to shift the focus of the agency's policy toward the enhancement of competition, rather than simply "preserving" competition. Indeed, the League believes that the application of the Board's prior policy has in fact produced a result in which competition was in fact not preserved, but rather has resulted in the loss of rail-to-rail competition as mergers over the past decade have been approved.

These reductions in competition have principally occurred in two areas: the loss of what the League will refer to as "segment competition," and the loss of product and geographic competition.

First, shippers have lost competition provided by carriers over part of a rail movement, when mergers involving the combination of end-to-end routes have been permitted without

ameliorating conditions. For example, if a shipper had been served by Railroad A at origin, but Railroads B and C both could have served the destination, then prior to a merger of Railroads A and B the shipper possessed the benefit of competition over at least a portion of the route, through the competition for the traffic between Railroad B and C as neutral connections to Railroad A. However, as a result of the application of its "one-lump" theory, the Board has permitted mergers of an upstream Carrier A and a downstream Carrier B with no ameliorating conditions to compensate for the loss of segment competition between two downstream carriers when one of those carriers merged with a neutral connection upstream. (The same loss of segment competition has occurred when a neutral downstream carrier merges with one of two competitive rail carriers upstream).

The loss of such segment competition has had both business and legal ramifications.

As a business matter, the League clearly understands from the first hand experience of its members that the "one lump" theory is terribly flawed in practice. The virtually universal experience reported by League members is that two competing "downstream" carriers do compete, and that shippers do in fact obtain the benefit of that competition, even though there is an upstream carrier that, for example, solely serves the shipper's origin facility. The business result of a merger of an upstream carrier with one of two neutral and competitive downstream carriers is to eliminate the competition provided by the other competitive downstream carrier, as the merged carrier either completely eliminates any interchange with that downstream carrier (for example, by refusing to quote joint line rates over the downstream carrier), or by simply increasing its portion of the rates over the joint line route (so that the formerly competitive route becomes completely uneconomic). Although the "one lump" theory would predict that the merger of the upstream and downstream carrier would have no effect on the total price and service package paid by the shipper, League members report that this is simply not the case.

Moreover, as a legal matter, the merger of an upstream and downstream carrier has completely eliminated whatever little legal protection had been provided by the Board's "contract exception" to its bottleneck decision, since a merger of an upstream rail carrier with one of two competitive downstream carriers eliminates the "contract exception" as a matter of law. See, STB Docket No. 41212, *Central Power and Light Company, et al v. Southern Pacific Transportation Company,* decisions served December 31, 1996 and April 30, 1997, *aff'd MidAmerican Energy Company v. Surface Transportation Board,* No. 97-1081, decision entered by the United States Court of Appeals for the Eighth Circuit, February 10, 1999.

Second, rail mergers of the size and scope of those approved since 1994 have vastly reduced the amount of potential leverage provided by geographic competition, as carriers with much broader rail systems began to serve more and more of the producing and consuming regions for various commodities. Since 1990, the loss of geographic competition has been gradual, but the cumulative effect has, in the view of League members, been very real. From a systemic standpoint, in chemicals, coal, agricultural products and other commodities, a single carrier now often serves many of the producing and/or consuming regions for that commodity, thus eliminating the leverage that one shipper might have had to enable it to argue that an unfavorable rate from the rail carrier serving its plant would simply accrue to the benefit of another carrier serving the plant of his competitor. From an individual shipper's standpoint, a single carrier is today much more likely to serve multiple plants of a single shipper, thus eliminating whatever leverage the shipper may have had to play carriers off against one another, even when the shipper's individual plants were singly served. From both standpoints, there has been a significant deterioration in the shipper's competitive position vis-à-vis its serving rail carrier or carriers.

The Board's proposed rules clearly represent a welcome departure from the policies that have to date resulted in these competitive losses. For example, in the NPR, the agency has called for carriers to preserve existing major gateways and to provide for the continued opportunity to enter into contracts for one segment of a movement as a means of gaining the right to separately pursue rate relief for the remainder of the movement (proposed Section 1180.1(c)(2)). In proposing these changes, the agency has impliedly discarded the "one lump" theory.[1] And in proposed Section 1180.1(c), the Board for the first time explicitly recognizes that mergers can result (and future mergers will result) in the loss of geographic competition. While the proposed rules do not ameliorate the competitive losses that have already occurred, these are positive changes for the future, and the League believes that they are clearly correct.

Especially in light of these losses in competition in past mergers and the likelihood that there will be even greater losses in future rail consolidations, the League also believes that the Board is correct in calling for "enhanced competition" as the cornerstone of its proposed new merger policy. As noted above, the League believes that past mergers have themselves resulted in a loss of competition in key areas, and future merger or consolidation applications will, unless treated significantly differently than in the past, will ineluctably result in competitive harms.

The Board's call for "enhanced competition" should not be, and is not as the League understands it, a negative presumption against rail mergers. Rather, the League believes that the Board's past merger policy, by narrowly focusing only on the competitive harm of parallel mergers at specific geographic points (e.g., "2-to-1" points, build-out points, etc.), while ignoring the competitive effects as end-to-end routes are combined, has lost sight of the fact that rail

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1 However, as noted at page 19 *infra*, the League believes that the Board should clarify its discussion of the closure of existing gateways, to make sure that interchanges remain open both physically and economically.

mergers of the size and scope of those recently approved, and of the size and scope that could take place in the future, result in systemic losses in competition that geographically-specific ameliorating conditions simply do not cure. The analytical framework within which the Board operates in rail merger proceedings thus must be revised and broadened, and a renewed focus on and sensitivity to the complex and subtle tones and tints of competition in the rail marketplace must be the place to start.

Indeed, the League's concern about competition is not just an academic one, or a parochial concern focused only on achieving "lower rates." League members strongly believe that competition is the only means of achieving an efficient and consumer-responsive rail marketplace. Much has been made recently about the need for the rail industry to provide its customers with greater "value," particularly in the form of predictable and reliable rail service. Broad rail-to-rail competition provides a systemic spur – one felt from corporate offices all the way to individual workers in the field – to achieve these results. Competition provides the motivation to a corporation to risk innovative improvements vital to the health of the United States' transportation system, which otherwise might not take place and without which the rail industry will never grow its "bottom line." Finally, the Board should not lose sight of the fact that, if the agency fails to focus on enhancing rail-to-rail competition in the transportation marketplace or simply gives lip-service to the concept, there could be a reversal in the rail arena of the fundamental direction of domestic and international transportation policy since the passage of the Staggers Act, namely, that the shipping public is best served through a lessening of comprehensive regulation in favor of a reliance on the competitive market. To continue down the path of the agency's current merger rules would lead to two market-dominant, inefficient, and uncompetitive transcontinental rail carriers, for whom calls for comprehensive re-regulation of rates and service would inevitably arise. This is not a result sought by the League, and the surest

way to prevent this result is for the Board to act forcibly to insure that the forces of competition flower in the rail industry to their fullest possible extent.

III. THE LEAGUE BELIEVES THAT THE BOARD SHOULD MAKE ITS RULES SUBSTANTIALLY MORE SPECIFIC, TO CLARIFY THAT "ENHANCED COMPETITION" MUST INCLUDE RAIL-TO-RAIL COMPETITION, AND SO THAT BOTH CARRIERS AND SHIPPERS HAVE A CLEARER IDEA OF WHAT SUCH ENHANCED RAIL TO RAIL COMPETITION MUST ENCOMPASS

While the League believes that the Board is correct in calling for "enhanced competition" in future rail consolidation proceedings, it also believes that the Board's proposed rules must be substantially more specific. While the League recognizes that the Board is acting at the level of broad policy and therefore needs to provide for a certain amount of flexibility in its rules to cover situations as they arise, the proposed rules are so vague as to provide neither shippers nor carriers with clear notice of what is required, and what will be expected, in the area of "enhanced competition." In other words, the Board has to strike a proper balance between flexibility and broad coverage, on the one hand, and specificity on the other. However, the League believes that the proper balance between flexibility and specificity has not been struck in the proposed rules. Therefore, the League urges the Board to revise the proposed rules to provide for further specificity as to what will be expected of applicant carriers in the area of "enhanced competition" in the future.

There are five areas dealing with the concept of "enhanced competition" upon which the Board should focus in making its proposed rules more specific, or in clarifying or modifying the proposed wording. (As noted in subsequent sections of these Comments, there are also a number

of other places in the proposed rules where the Board should more clearly specify what will be required and what will be allowed under its proposed rules).[2]

First, although the Board's proposed rules specify in a number of places that merger applications must include provisions for "enhanced competition" (see *e.g.*, proposed §1180.1(c)), they never clearly specify that such "enhanced competition" must include provisions for enhanced rail-to-rail competition. This is an extremely serious lack. Rail carriers in all mergers since 1990 have touted the "enhanced competition" that the proposed merger would provide to truck and barge competitors: indeed, such "enhanced competition" between modes was largely the rationale upon which past merger applications were based, and largely the rationale upon which they were approved. But enhanced intermodal competition would do nothing to cure the anti-competitive effects noted above (*i.e.,* the loss of segment competition and the loss of geographic competition). If future merger policy is to be truly different from past merger policy, the Board's rules must specify that "enhanced competition" must provide for enhanced rail-to-rail or intramodal competition in a significant way.

Thus, the League suggests that, at a minimum, the fourth sentence of proposed §1180.1(c) be revised to read: *"To maintain a balance in favor of the public interest, merger applications must include provisions for enhanced competition, including, but not limited to, significant enhancements of rail-to-rail (intramodal) competition in the area affected by the proposed merger."* The second to the last sentence of proposed §1180.1(a) should replace the words "enhanced competition" with the words "*enhanced intramodal competition.*" Finally, the

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2 The League would note that, if the Board makes its rules substantially more specific, there is the possibility that the Board could, either in its proposed rules or in an individual case, be able to process a proposed rail consolidation application more expeditiously than the proposed rules presently contemplate.

second to the last sentence of proposed §1180.1(d) should also be revised so that the term "enhanced competition" should be replaced with the term "*enhanced intramodal competition.*"

Second, the League believes that the Board should revise its proposed rules to include examples of enhanced "rail-to-rail" competition that the Board expects applicant carriers to consider when submitting an application to the agency. Specifically, the League suggests that the wording of proposed §1180.1(c)(2)(iv) be revised as follows:

> *"Enhanced competition. Applicants shall propose conditions for enhanced competition, including but not limited to enhanced rail-to-rail competition, in all or major parts of the geographic area affected by the proposed merger. Such proposals may include provisions for the introduction of reciprocal switching where it has not previously existed or expanded reciprocal switching in terminal areas or at interchanges, at rates that reflect the cost of service; commitments to provide contract and common carrier rates to interchanges; elimination of existing and future barriers to short lines providing competitive rail service; establishment of terminal carriers to connect with railroads serving an area; and similar proposals."*

Third, the League believes that the wording of the fourth sentence of proposed Section 1180.1(a) should be revised to clarify what appears to be an unintended ambiguity in the proposed rules. That sentence states that the Board "does not favor" consolidations that reduce the railroad and other transportation alternatives "unless there are substantial and demonstrable public benefits to the transaction that cannot otherwise be achieved." This wording suggests that the Board <u>does</u> favor consolidations that reduce railroad and other transportation alternatives as long as there <u>are</u> substantial public benefits. But such an interpretation (permitted by the proposed wording) would be flatly inconsistent with sound public policy, and inconsistent even with the Board's past practice. Specifically, the Board should make clear that, where a reduction in competition can be specifically proved, then such specifically-identified reductions in competition <u>should be cured</u> as part of the Board's requirements for approval of the proposed merger. "Offsets" to such specifically-identified competitive harm that increase competition

elsewhere, simply cannot suffice. Thus, the League believes that the wording of the fourth sentence of proposed Section 1180.1(a) should be clarified, by changing the proposed rule so that it simply states that the Board "*does not favor consolidations that reduce railroad and other transportation alternatives.*" Such wording would be consistent with the Board's call for "enhanced competition," and would make clear that where there is a reduction in competitive alternatives, these must be cured before a proposed transaction can be approved.

Fourth, proposed Section 1180.1(c) of the proposed rules appears to indicate that the standard of "enhanced competition" will be applicable only where both carriers are "financially sound" ("To maintain a balance in favor of the public interest, merger applications must include provisions for enhanced competition. Unless merger applications are so framed, approval of proposed combinations *where both carriers are financially sound* will likely cause the Board to make broad use of its powers . . . to condition its approval to preserve and enhance competition." [emphasis added]). But the Board never specifies what it considers to be a "financially sound" rail carrier. In its "revenue adequacy" determinations, the agency has for years declared virtually all Class I rail carriers in the nation to be "revenue inadequate." The League would strongly object if the Board's clearly-flawed "revenue adequacy" determinations were used in any way to dilute the strength of the Board's proposed rule to "enhance competition," or if the standard of "financial soundness" were used to dilute the protections envisioned by the proposed rules. While general merger policy under the Sherman Act leaves room for approval of a merger where there is a "failing firm," the standards of the "failing firm" doctrine are much more stringent than the Board's apparent reliance on "financial soundness." *Committee for an Independent P-I v. Hearst Corp.*, 704 F.2d 467, 473-74 (9th Cir. 1983) ("This doctrine provides a defense to otherwise illegal mergers when it is shown that one of the businesses is a 'failing company,' which means it is on the brink of collapse, its prospects for reorganization are dim or nonexistent,

and no other competing buyers are available."); *Reilly v. Hearst Corp.,* 107 F. Supp.2d 1192 (N.D. CA 2000); *Citizen Publishing v. U.S.,* 394 U.S. 131 (1969); *International Shoe Co. v. FTC*, 280 U.S. 291 (1930). The Board should therefore completely eliminate the phrase "*where both carriers are financially sound*" in the fifth sentence of proposed §1180.1(c).

Finally, in proposed section 1180.1(d), the Board states that it would not impose conditions that would result in "unreasonable operating, financial, or other problems for the combined carrier." The League believes that this language is far too broad, and could be a source of mischief. The preservation of existing competition in all of its forms, and the development of "enhanced competition," may result in short- to medium-term reductions in the financial benefits of a proposed rail consolidation, compared to those financial benefits that would otherwise accrue. Under the currently-proposed wording, a rail carrier might argue that the preservation or enhancement of competition would result in an "unreasonable" financial burden for the carrier, such that if the condition or conditions were imposed, the two merging carriers would not go forward with the proposed transaction, and thus the nation would lose the contemplated "benefits" of the proposed transaction. The Board's final rule should not permit such a position. If competitive harm can only be remedied, or enhancements to competition can only be obtained, through the imposition of conditions that will result in a reduction in the financial benefits to the transaction, then the financial terms of the transaction must be altered, rather than the competitive harm be ignored. Thus, the League believes that the phrase "*financial or other*" should be eliminated from the third sentence of proposed Section 1180.1(d).

IV. BY FOCUSING PURELY ON MERGING CARRIERS, THE BOARD'S APPROACH WOULD RESULT IN AN UNLEVEL COMPETITIVE PLAYING FIELD BETWEEN MERGING AND NON-MERGING CARRIERS. TO CURE THIS DEFICIENCY IN THE AGENCY'S APPROACH, THE BOARD SHOULD COMMIT TO APPLY ITS TERMINAL ACCESS RULES TO INTERCHANGES BETWEEN MERGING AND NON-MERGING CARRIERS, TO INSURE THERE IS LEVEL COMPETITION IN THE RAIL MARKETPLACE

As noted above, the League supports the Board's overall proposed policy change that would give a heightened emphasis to enhancing competition in the context of mergers. However, the League is extremely concerned that, by focusing purely on merger policy to accomplish this objective, the agency is creating an "unlevel playing field" for carriers and shippers. Specifically, if two carriers decide to merge, under the Board's proposal the merging carriers must propose "enhanced competition" as part of their merger application. Assuming that the Board clarifies, as requested by the League above, that this requirement must include enhanced rail-to-rail competition, then the two merging carriers must provide some type of access to their systems to non-merging carriers in their geographic area. However, while the two merging carriers will be required to provide some access to their competitors to their systems, these other carriers will not be obligated to provide access to their own systems. Thus, the merging carriers will be unable to compete for traffic on the systems of non-merging carriers. Not only will this result in a significant disincentive for potentially beneficial transactions (particularly given the vagueness of the proposed rules as to what quantum of "enhanced competition" will be necessary to win agency approval of a proposed transaction), but will also result in an inequitable and asymmetrical situation for shippers on the non-merging versus merging carriers.

Thus, the League believes that the Board must act to provide for enhanced competition not just on the lines of the merging carriers, but should act to permit enhanced competition on the lines of non-merging carriers as well. It seems clear that the Board can utilize its conditioning

power to provide for enhanced competition (such as increased reciprocal switching) on the lines of the merging carriers, but it would appear to be much more problematic as a legal matter for the Board to utilize its conditioning authority to require enhanced competition on the lines of non-merging carriers.

However, the Board can act directly on non-merging carriers in at least some areas of enhanced competition such as terminal trackage rights and reciprocal switching. Under 49 U.S.C. §11102(a), the Board can order trackage rights where it finds such trackage rights to be "practicable and in the public interest without substantially impairing the ability of the rail carrier owning the facilities or entitled to use the facilities to handle its own business." Under 49 U.S.C. §11102(c), the Board can order reciprocal switching where it finds that reciprocal switching is "practicable and in the public interest," or where reciprocal switching is "necessary to provide competitive rail service." It is important to note that the Board has ordered trackage rights under Section 11102 (formerly section 11103) in past mergers, to permit carriers' access over the lines of non-merging carriers, in order to advance the public interest. For example, in the UP/SP merger decision, the STB granted terminal trackage rights to the BNSF to use segments of track owned by the Kansas City Southern Railway company, in order to allow BNSF to provide a competitive alternative to UP/SP over a key corridor that would otherwise have been dominated by the merged UP/SP. STB Finance Docket No. 32760, *Union Pacific Railroad Corporation, et al – Control and Merger – Southern Pacific Rail Corporation, et al,* decision served August 12, 1996, pp. 167-171. In ordering such access, the agency specifically ruled that it would not impose the "relatively exacting" tests set forth by and the precedents created under its rules in Ex Parte 445 (Sub-No. 1), *Intramodal Rail Competition,* but would merely apply the broad "public interest" standard in former section 11103 and the public interest standard in former section 11343. *Id.* at 171. Similarly, in the UP/MP merger, the ICC imposed a condition granting the

DRGW trackage rights over a line between Pueblo, Colorado and Kansas City, MO, part of which was owned by a non-applicant, the Santa Fe Railway Company. *Union Pacific Corporation, et al – Control – Missouri Pacific Corporation, et al*, 366 I.C.C. 462, 572 (1982). The ICC determined that granting access to that line to make the agency's overall merger conditions effective would be in the public interest. The Court of Appeals affirmed that decision. *Southern Pacific Transportation Company v. Interstate Commerce Commission*, 736 F.2d 708, 722-24 (D.C. Cir. 1984). Thus, it appears clear that the Board has legal authority in merger proceedings to utilize terminal trackage rights and reciprocal switching broadly to promote the public interest.[3]

The League believes that the Board should revise its merger rules to make clear that, if "enhanced competition" is ordered over the lines of merging carriers, the Board would act broadly and symmetrically to impose concomitant access over the lines of non-merging carriers, to provide for equal competition. This could be done by adding the following as a new seventh sentence to proposed Section 1180.1(d): *"In the case of enhanced competition proposed by applicants or ordered by the Board resulting in access to the lines of applicant carriers by other rail carriers, the Board will also impose access under the authority granted to it by 49 U.S.C. §11102 to permit comparable access over the lines of such other rail carriers, at the same or similar locations."* For example, if the Board were to order "enhanced competition" through reciprocal switching at designated terminals of two merging carriers, then it would act broadly under Section 11102 to order reciprocal switching over the lines of non-merging carriers at those

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[3] In STB Docket No. 33556, *Canadian National Railway Company, et al – Control – Illinois Central Corporation*, decision served May 25, 1999, at p. 52, the agency refused to grant trackage rights over the lines of a non-applicant carrier to permit an improved interchange, because the trackage rights were not merger-related. Trackage rights or reciprocal switching as

same terminal areas, so that the benefits of competition could be obtained by all shippers in the area affected by the merger. Similarly, if terminal trackage rights are ordered over the lines of merging carriers in order to enhance competition, then similar trackage rights would be ordered over the lines of non-merging carriers in the affected areas. In the alternative, the Board could commit to reopen its Ex Parte 445 (Sub-No. 1) rules when and if the next merger application of two Class I carriers is filed, to permit competitive access to both merging and non-merging carriers in terminal areas at which merging carriers interchange cars with non-merging carriers.

V. THE BOARD MUST DEFINE ITS RULES REGARDING THE PRESERVATION OF "MAJOR EXISTING GATEWAYS"

In proposed Section 1180.1(c)(2), the Board would require merger applicants to explain how they would at a minimum preserve existing competitive options such as the use of major existing gateways, and the opportunity to enter contracts for one segment of a movement as a means of gaining the right to separately pursue rate relief for the remainder of a movement.

The League applauds these changes. However, it believes that, with respect to major existing gateways, the Board's rules need substantial clarification and definition.

First, the Board should clarify the phrase "major existing gateways," a term whose meaning is completely undefined in the proposed rules. Indeed, the League believes that the term is a flawed one, because there is no objective measure as to what constitutes a "gateway" as opposed to an ordinary "interchange," and the use of the adjective "major" in the agency's proposed formulation simply confuses the issue even more. The League believes that the term should be discarded by the Board in favor of a more objective and precise one. Specifically, the League suggests that the proper area of inquiry is whether there is an "existing interchange"

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requested by the League, however, would clearly be related to the consolidation application, and

between an applicant carrier and a non-applicant carrier. There is substantial precedent within the agency and its predecessor regarding the definition of an "interchange," and that determination depends upon physically-verifiable conditions such as whether there is an actual exchange of cars between the two carriers at a specific geographic point. *E.g., U.S. v. Terminal Railroad Ass'n*, 397 F.2d 467, 471 (7th Cir. 1968); *Southern Railway Co. v. Louisville and Nashville R. Co.,* 185 F. Supp. 645, 651 (W.D. Ky. 1960), *aff'd* 289 F.2d 934 (6th Cir. 1961).

Assuming that the Board would focus on whether there is an "existing interchange" between a merging and a non-merging carrier rather than a "major gateway," the question then becomes the proper standard for determining whether an existing interchange should be preserved. The League agrees with the NPR that rail carriers have to a large extent, as a result of recent mergers and business conditions, closed in one manner or another existing interchanges that the carriers claim are inefficient. NPR, p. 15. However, the League does not agree that all interchanges that have been closed to date have in fact been inefficient interchanges. But assuming *arguendo* that the Board is correct that most, if not all, inefficient interchanges have already been closed, then the League suggests that the proper regulatory standard here should forbid merging carriers, either as part of the application or in the future, from closing any existing interchange unless the carrier could show clearly that the existing interchange is not necessary to preserve the competitive routing options of any shipper or that maintenance of the existing interchange would be patently inefficient. The "patently inefficient" standard would place the burden on the carrier to show that any proposed or future interchange closure was indeed justified.

Second, the Board should clarify what it means when it says that carriers must "preserve" gateways. See proposed Section 1180.1(c)(2)(i). Interchanges can be "closed" through many

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would not simply be for the operational convenience of another rail carrier.

means: by tearing up track; by not permitting the exchange of cars with another carrier at a particular geographic point; and by pricing routings over a particular interchange with another carrier so as to make transportation via that route uneconomic to any shipper. The Board should make clear in its rule that carriers must explain how they would preserve the routing over such interchanges not just physically (*i.e.,* by permitting routing over the gateway), but also economically, that is, by insuring that the rate to be charged to the interchange permits competition over the remainder of the movement.

In order to accomplish these two clarifications and changes, the League suggests that the last sentence of proposed Section 1180.1(c)(2)(i) be revised as follows: *"Applicants shall also explain how they would at a minimum preserve existing competitive options including but not limited to those involving the use of existing interchanges, build-outs or build-ins, and the opportunity to enter into contracts for one segment of a movement as a means of gaining the right to separately to pursue rate relief for the remainder of the movement. The Board shall not permit the closure of existing interchanges by any means (through direct interchange closures, rate increases, or otherwise) unless the applicants can show clearly that an existing interchange is not necessary to preserve the competitive routing options of any shipper, or that maintenance of the existing interchange would be patently inefficient."*

VI. THE BOARD SHOULD CLARIFY THE CONTENTS AND REQUIREMENTS TO BE INCLUDED IN A "SERVICE ASSURANCE PLAN." SUCH PLANS SHOULD INCLUDE PROVISIONS FOR THE COMPENSATION OF SHIPPERS IN THE EVENT THAT PROMISED SERVICE DOES NOT MATERIALIZE, AND EXPEDITED, MANDATORY ARBITRATION OF SERVICE DISPUTES

Under proposed Sections 1180.1(h) and 1180.10, the Board would require applicant carriers to file, as part of their initial application and operating plan, a "service assurance plan" that would identify the precise steps to be taken to ensure the continuation of adequate service and to provide for improved service. The League believes that the Board's proposed rules should

specify clearly the level of detail required, including agreements with other carriers to deal with contingencies (for example, agreements to waive "paper barriers" in the event of service failures).[4] Thus, the League supports the Board's call for a service assurance plan, and believes that such a plan, if modified appropriately as described in these comments, would provide a useful addition to the requirements for approval of future rail consolidations.

However, the League believes that the existence of a service assurance plan, by itself, is not enough. The Board's requirement for a "service assurance plan" is silent as to whether, and how, shippers would be compensated for a carrier's failure to meet the levels of service proposed in its application, or even worse, for a carrier's failure to provide even the levels of service experienced by shippers pre-merger. It is clear to the League that, if the recent mergers teach anything, it is that carrier plans and public statements assuring improved service are not in short supply when carriers propose to merge. In the UP/SP merger, the Board and shippers were repeatedly told that the UP had learned from its mistakes in integrating the Chicago and North Western Transportation Company into its system, and that there would be no similar service failure in integrating the SP into the UP's system – but the disastrous western meltdown promptly followed on the heels of these rosy assurances. Likewise, in the NS/CSX/Conrail transaction, the Board and shippers were repeatedly told that the two acquiring carriers had learned from the UP/SP debacle, and that there were unprecedented levels of planning -- yet months of service disruption still occurred, despite that planning. Any service assurance plan, therefore, must include provisions for the compensation of shippers in the event that promised

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[4] As part of the Conrail Transaction Council meetings, CSX provided the League with an example of a hurricane recovery plan which set forth in useful detail the types of service recovery that would be implemented in the event of such a natural disaster, including arrangements worked out in advance for trackage rights with alternate carriers. Likewise, NS agreed to waive

service levels degrade from those experienced prior to the merger. Only if carriers are aware beforehand that failure to provide promised service levels will result in sure financial penalties, will service be truly "assured."

The League, then, suggests three alterations to the Board's proposed rules.

First, as discussed above, the Board's proposal for a service assurance plan should require, as part of that plan, provisions for compensation to shippers if service levels degrade from those experienced prior to the transaction, at any time. The Board should also be clear that any remedies in a service assurance plan should complement, and should not replace, remedies that the shipper might already have against the carrier as part, for example, of a shipper's contract with the carrier.[5]

Second, the League believes that not only should the right of compensation be included in any service plan, but that an expeditious and fair procedure for obtaining just compensation should be provided for as well. In the past, if a carrier has denied a shipper's claim, the shipper has been obligated to go to court to obtain compensation for the carrier's service failures. This is an expensive and lengthy proposition, and one which discouraged many shippers from pursuing their rights at all. Accordingly, the League believes that service assurance plans should include a provision for expedited arbitration (e.g., to be completed within 90 days),[6] at the shipper's election, of disputes over compensation for rail service failures as a result of a consolidation

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paper barriers for at least one Class III railroad in Pennsylvania during service problems in 1999. Similar or greater levels of detail should be provided in a service assurance plan.

5 In other words, the inclusion of remedies in a carrier's service assurance plan as a condition of the merger, combined with the agency's authority to exempt a merger from the force of other law, should not act to strip a shipper of its existing rights. Of course, a shipper would be limited only to the total damages the shipper has suffered, and would not be eligible for any double recovery.

6 This might include allowance for expedited mediation, to resolve the dispute quickly.

transaction, for a reasonable time after a consolidation is implemented. Recent history would suggest that a "reasonable time" after implementation of a transaction would need to be at least one year.

Finally, if there is service deterioration after a consolidation transaction, shippers primarily want, not compensation for damages resulting from the service failure, but service from another carrier so that any damages are minimized. After all, some damages – to customer relations, to a shipper's competitive presence in a particular market, to a shipper's very reputation – are difficult if not impossible to compensate. Accordingly, the League suggests that, if there are service disruptions following the implementation of a proposed consolidation transaction, the service assurance plan should be required to provide for access by alternative carriers to remedy the service failures.

In this connection, the League believes that the Board's recently-published rules in Ex Parte 628, *Expedited Relief for Service Inadequacies*, decision served December 21, 1998, could be utilized in connection with this relief. Under those rules, a shipper must show a "measurable deterioration in rail service" or "other demonstrated inadequacy" in rail service, along with advance discussions with the shipper's incumbent carrier and a commitment from another railroad to provide safe and operationally feasible service, in order to obtain emergency or temporary service relief. The Board should consider requiring applicant carriers to link service levels in their service assurance plans with the Board's Ex Parte No. 628 standards for proving a "measurable deterioration" in rail service. If service fell below that level, then a shipper would not have to prove that there was a "measurable deterioration" in rail service, but could simply show that he had attempted to resolve the service problem with the carrier, and that he had a carrier willing and able to provide substituted service. Thus, a carrier's service assurance plan would need to provide that, if service levels for any shipper deteriorated *x* percent from service

levels experienced by that shipper for a reasonable period prior to implementation of the transaction, then the Board would presume that there had been a "measurable deterioration in rail service" for the purpose of ordering relief under Ex Parte 628 on an emergency or temporary basis.

The following addition at the end of proposed Section 1180.1(h) (and concomitant changes to proposed Section 1180.10) would be necessary to implement the suggestions set forth by the League in this section of its Comments: *"A service assurance plan shall also include provision for the compensation of shippers for damages experienced as a result of the failure of the applicant carriers to provide service to any shipper at levels experienced prior to the implementation of the transaction; and expedited arbitration which shall be available for a reasonable time after implementation of the transaction, at the shipper's election, to resolve the amount of damages suffered by the shipper as a result of service deterioration. Such remedies, however, shall not preempt other remedies available to the shipper under law. A service assurance plan shall also contain standards under which the Board shall presume as a prima facie matter that there is a "substantial, measurable deterioration" in rail service for any shipper under 49 C.F.R. §§1146.1(a) and 1147.1(a), for the purpose of providing substituted service in the event of service disruptions.*

VII. THE LEAGUE SUPPORTS THE BOARD'S PROPOSAL FOR INCREASED OPERATIONAL MONITORING AND OVERSIGHT, BUT BELIEVES THAT CERTAIN ADDITIONS AND CLARIFICATIONS SHOULD BE MADE

The League supports the Board's call for increased monitoring and oversight. The League believes that the five-year oversight period set forth in proposed Section 1180.1(g) is appropriate, and that provisions for "extensive post-operational monitoring" and the establishment of a Service Council in proposed Section 1180.1(h)(2) and (3) are useful additions

to the Board's current rules. In particular, the League believes that the Board is correct in requiring carriers to provide baseline, "benchmark" data, so that shippers may have a clear idea of how a merger is actually progressing. See proposed Section 1180.10(a) and (c).

However, the League believes that the Board's proposed rules focus too much on generalized operational data that has proved insufficient in the past, and does not include key operational information. Specifically, the Board's proposed rules for service assurance plans and operational monitoring appear to require only generalized data such as dwell time (see proposed 1180.1(c)), on-time performance at principal yards (*id.*), and perhaps train speeds for determining operational success. The League strongly believes that this information is not sufficient. The League's experience during the Conrail transaction has been that this information, though giving a very broad picture of the operational health of a carrier, did not identify service problems in specific geographic areas, and was not sensitive enough to service deterioration to be truly useful. For example, yard dwell time might indicate that one or more yards were experiencing problems, but could not identify the areas which these delays affected, which were often hundreds of miles from the yards themselves.

Thus, the League believes that, as part of this requirement for operational monitoring, applicant carriers should be required to provide information on transit times and/or cycle times over major corridors for the year prior to the application, and then should be obligated to provide that information on a continuing basis following the implementation of the transaction. Transit time information is the most important and direct determinant of the quality of a carrier's service. In this regard, the League would note that CSX Transportation Company has recently announced a feature whereby prospective shippers can obtain transit time information, as well as a rate quote, between all origin and destination areas on CSX's system. Moreover, BNSF and CN have recently announced that they have attained high levels of "on-time" service, a claim that directly

implies that the carriers possess and utilize data on the transit times of all movements over their system. Thus, it is clear that the nation's rail carriers have such data available. Moreover, CSX's willingness to reveal such data publicly clearly indicates that any claim of competitive harm from the release of this data would not be sustainable. Accordingly, the Board should insert the following as a new fifth sentence in proposed Section 1180.10(a): *"The plan shall provide to the public information on transit and/or cycle times for traffic categories over major corridors for the year immediately preceding the application, and the applicants shall provide the same information on an ongoing basis following the application and implementation of the transaction."*

VIII. THE BOARD SHOULD INCLUDE IN ITS PROPOSED RULES A PROHIBITION AGAINST INCLUDING ANY ACQUISITION PREMIUM IN DETERMINING REVENUE ADEQUACY AND REASONABLE RATES, AND SHOULD EXAMINE MORE CLOSELY THAN IT HAS IN THE PAST THE FINANCIAL BURDENS THAT APPLICANT CARRIERS ASSUME IN A PROPOSED TRANSACTION

The League believes that the Board should also, as part of its revision to its merger rules, revise its approach to the so-called "acquisition premium" in rail mergers. As the Board is aware, the agency has permitted the difference between the purchase price of a rail acquisition and the market or book value just prior to acquisition, to be included in the calculation of both the jurisdictional threshold for rate regulation and railroad revenue adequacy. As a result of the inclusion of an acquisition premium, the jurisdictional threshold will rise, and the railroad is more likely to be adjudged revenue inadequate. Moreover, since the acquisition premium costs work their way into RCAF calculations, shippers that utilize the RCAF in their contracts may also be adversely affected.

Thus, the League believes that the Board should revise its proposed rules to forbid carriers from including any acquisition premium in its calculation of either the jurisdictional threshold or in evaluating a carrier's revenue adequacy.

Finally, the League believes that, in addition to an increased level of scrutiny of claims of future merger benefits, the Board should undertake to examine, more carefully than it has in the past, the possible effects of the financial burden imposed by a proposed consolidation transaction. Under 49 U.S.C. §11324, the Board is required to consider "the total fixed charges that result from the proposed transaction." Though the Board has examined this factor in past merger proceedings, the Board has tended to give substantial credence to carriers' claims that the financial obligations assumed as a result of a proposed transaction will not adversely affect the shipping public. However, League members report that they are beginning to experience in the eastern United States rate increases that do not appear to be justified by the carriers' cost increases, a development that shippers believe to be at least in part related to the very substantial debt levels assumed by both NS and CSX as part of their purchase of Conrail. The Board needs to recognize that there is a very substantial incentive in rail consolidation applications for the applicants to place the very best "face" on all aspects of the proposed transaction, including the financial aspects. The Board needs to scrutinize these claims as carefully as it indicates that it will do with respect to claimed merger benefits and operations.

IX. THE BOARD SHOULD BE CAUTIOUS IN ITS TREATMENT OF OPERATIONAL ALLIANCES, TO INSURE THAT ANY ANTICOMPETITIVE EFFECTS OF SUCH ALLIANCES ARE CAREFULLY REVIEWED

In the last two sentences of proposed Section 1180.1(c), the Board states that, in evaluating the public interest, the Board will consider whether the benefits claimed by the applicants could be realized by means other than the proposed consolidation; and that the Board

believes that other private sector initiatives, such as joint marketing agreements "can produce many of the efficiencies of a merger while risking less potential harm to the public."

The League supports the first of these two sentences, and agrees that the Board should evaluate whether the benefits claimed by the proposed applicants could be realized without risking any potential harms posed by a proposed merger. However, the League is concerned, particularly absent a specific case at hand, that the Board not too broadly "bless" other types of arrangements, especially given (as discussed further below) the uncertain oversight of such arrangements.

For example, in the Illinois Central/Canadian National merger, there were serious questions raised about the competitive effect of joint agreements between one or more of the applicants and the Kansas City Southern Railroad. While these were eventually resolved by the Board in the context of that merger, other joint marketing or interline partnerships might have similar or even more serious anticompetitive consequences. And in the absence of a merger proceeding, it is not at all clear that such competitive concerns could be easily resolved. For example, in these proposed merger rules, the Board has stated that merger applicants must insure that major gateways be preserved. But what if Eastern Carrier A and Northern Carrier B entered into an alliance that included an agreement to commercially close certain designated gateways ostensibly in the interest of operational efficiency, but without a merger? The Board, other carriers, and concerned shippers could well find themselves on the "receiving end" of the Board's proposed rule that an interline partnership can produce many "efficiencies" "while risking less potential harm to the public."

As noted above, in proposed 49 C.F.R. §1180.1(c), the Board has indicated its intention to consider whether the claimed benefits of a merger "could be realized by means other than the proposed consolidation ... such as joint marketing agreements and interline partnerships." NPR

at 13-14. While such other means may provide efficiency benefits, the Board must remain aware that such arrangements could escape regulatory review, either by the Board or by other agencies charged with administering competition policy.

The statute defines both "control" and achievement of control very broadly. *See* 49 U.S.C.A. § 10102(3) and 11323(b) and (c), and *United States v. Marshall Transport Co.*, 322 U.S. 31, 38 (1944). However, the Board's recent decisions (following other recent decisions of the ICC) have seemed to follow a narrower definition of control, so that significant involvement of the one rail carrier in the management and operations of another rail carriers has not been found to reflect an achievement of control sufficient to require regulatory approval.

For example, in its decision in the CN/IC merger, the Board found that a so-called "alliance agreement" between the Canadian National Railway system and the Kansas City Southern Railway system was not subject to the Board's authority. The Board found that, on the facts presented on the record, the alliance was not a form of common control requiring approval under 49 U.S.C.A. §§ 11323-24. The Board also found that the alliance agreement was not a pooling agreement that would require Board approval under 49 U.S.C.A. § 11322. CN/IC at 26-28.[7] Similarly, the ICC, in *Union Pacific R. Co. – Trackage Rights over Chicago and North Western Transp. Co.,* 7 I.C.C. 2d 177, 193-198 (1990) found that a series of ever-more intrusive business relationships between UP and CNW did not mean that UP had achieved control of CNW within the meaning of the same statutory provisions in the prior Act.

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7 The Board also found that the alliance agreement would not reduce competition both because it would not facilitate improper anti-competitive collusion between KCS and CN, and because the agreement would not foreclose efforts by those carriers to compete through build-out/build-in opportunities. CN/IC at 28-31.

While these decisions seem to limit the likelihood of review by the Board of non-merger cooperative agreements, the antitrust regulatory agencies, the U.S. Department of Justice and the Federal Trade Commission, have recently adopted new Antitrust Guidelines for Collaborations among Competitors (April 2000). Those Guidelines indicate that most agreements among competitors would be reviewed under the so-called "Rule of Reason" to determine if the agreement "harms competition by increasing the ability or incentive profitably to raise prices above or reduce output, quality, service or innovation below what likely would prevail in the absence of the relevant agreement." Section 1.2. Unless it can be shown that the overall competitive effect of a cooperative agreement among rail carriers is anti-competitive under this test, it will not be subject to challenge under the antitrust laws by the enforcement agencies. Thus, because the Guidelines were not developed with the specific situation regarding rail alliance agreements in mind, there may be certain situations involving cooperative agreements among rail carriers that would not only escape regulatory review if the Board continues with certain past precedent, but might also escape review under the antitrust laws.

As another example, the Guidelines states that those agencies would not challenge a competitor collaboration "when the market shares of the collaboration and its participants collectively account for no more than twenty percent of each relevant market in which competition may be affected." Section 4.2 [footnotes omitted]. Therefore, even when a cooperative agreement among rail carriers has an effect on competition, the antitrust agencies will not take enforcement action, as long as the combined market share is less that twenty percent. There is also no assurance that, in light of the recent decisions discussed above, that the Board would take any action either.

Thus, in view of all of the above, the League suggests that the Board delete the last sentence of proposed Section 1180.1(c).

X. THE BOARD SHOULD EXAMINE CUMULATIVE IMPACTS, WHICH SHOULD INCLUDE REASONABLY FORESEEABLE DOWNSTREAM EFFECTS, AS WELL AS DELETERIOUS "UPSTREAM" IMPACTS

The League is in full agreement with the Board that its current "one case at a time" rule has outlived its usefulness in an era where there are only a few remaining Class I carriers. The League would note that the Board may wish to evaluate the formulation of the standard set forth in the text of its proposed rule, namely, that applicants must anticipate "with as much certainty as possible" what additional Class I merger applications are likely to be filed in response to a merger application filed by two Class I carriers, since that formulation appears to be more exacting than the standard set forth in the text explaining the proposed rule, namely that it is appropriate for the Board to consider "reasonable arguments about likely future transactions and about the future structure of the industry." A more consistent formulation would be for the text of the rule to require applicants to anticipate "with reasonable certainty" what additional applications are likely to be filed.

Finally, the League is in agreement with Commissioner Burkes' suggestion that the applicants to a future major merger should address what impacts, if any, the proposed merger would have on conditions imposed by the agency in previously-approved mergers to preserve or enhance competition. As noted by the League in these comments, there has been a gradual loss of geographic and segment competition since the latest wave of major mergers began in 1994. It is entirely possible that a future merger may require a re-examination of past merger conditions, since only such a re-evaluation may uncover a serious loss of, for example, geographic competition if a major western carrier would merge with a major eastern carrier. For example, the merger of Western Carrier A with Eastern Carrier B may cause the combined system to possess a stranglehold over one commodity nationwide. But it may be possible to cure that result

by altering the configuration of trackage rights granted in a previous merger, to permit access to the western origins of the commodity by the non-merging western carrier. The League agrees with Commissioner Burkes that, at this point in time, the agency needs "to look at the whole picture and not, with blinders on, look just forward." NPR, p. 41.

XI. THE BOARD IS CORRECT IN ITS APPROACH TO TRANSNATIONAL ISSUES

The League supports in its entirety the Board's approach to transnational issues. It is crucial that, in cases involving major foreign railroads, applicants should submit "full system" competitive analyses and operating plans, including operations in the foreign country.

XII. CONCLUSION

The League appreciates the opportunity to make its views known to the Board, and respectfully requests the Board to consider these comments as it develops its rules in this proceeding.

Respectfully submitted

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November 17, 2000

Certificate of Service

I hereby certify that I have on this 17th day of November 2000 served a copy of the foregoing Comments on all parties identified in the Board's order in this proceeding, as required by the Board's order and rules of practice.